

Report
of the
Examination of
Group Health Cooperative of Eau Claire
Altoona, Wisconsin
As of December 31, 2004

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Jorge Gomez, Commissioner

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July 15, 2005

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Honorable Jorge Gomez
Commissioner of Insurance
Madison, Wisconsin

Commissioner:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

GROUP HEALTH COOPERATIVE OF EAU CLAIRE
Altoona, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Group Health Cooperative of Eau Claire (the cooperative or GHC-EC) was conducted in 2002 as of December 31, 2001. The current examination covered the intervening period ending December 31, 2004, and included a review of such 2005 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the cooperative's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Provider Contracts
- Territory and Plan of Operations
- Affiliated Companies
- Growth of the Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the cooperative's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the cooperative's operations is contained in the examination work papers.

The cooperative is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

GHC-EC can be described as a nonprofit network mixed model health maintenance organization (HMO) insurer. An HMO insurer is defined by s. 609.01 (2), Wis. Stat., as ". . . a health care plan offered by an organization established under ch. 185, 611, 613, or 614 or issued a certificate of authority under ch. 618 that makes available to its enrolled participants, in consideration for predetermined fixed payments, comprehensive health care services performed by providers selected by the organization." Under the mixed model, the cooperative has a delivery system consisting of a combination of staff physicians and/or one or more clinics and/or independent contracting physicians operating out of their separate offices. HMOs compete with traditional fee-for-service health care delivery.

The cooperative was incorporated on May 23, 1972, and commenced business on November 1, 1976. The cooperative is licensed under the provisions of ch. 185, Wis. Stat., as a cooperative association for sickness care.

GHC-EC was operating as a staff model HMO until January 1, 1998, when the cooperative sold its medical operations to Marshfield Clinic. GHC-EC now offers primary care services through 74 contracted clinic locations throughout its service area. Members are required to select one clinic location as the primary care clinic. Approximately 1,250 primary care providers are available to GHC-EC members, depending on type of coverage. Providers are reimbursed on a capitation or discounted fee-for-service basis. The contracts include hold-harmless provisions for the protection of policyholders. The contracts typically have a one-year term and may be terminated upon advance written notice.

GHC-EC contracts with over 90 clinic locations, representing 2,700 physicians, for the provision of specialty care services. Providers are generally reimbursed on a discounted fee-for-service basis. The contracts include hold-harmless provisions for the protection of enrollees. The contracts typically have a one-year term and may be terminated upon advance notice.

The cooperative contracts with the hospitals listed below to provide inpatient services. Hospitals are reimbursed on a negotiated per diem or discounted fee-for-service basis. The contracts include hold-harmless provisions for the protection of enrollees.

Abbot Northwestern Hospital-Minneapolis, MN
 Baldwin Area Medical Center-Baldwin, WI
 Black River Memorial Hospital-Black River Falls, WI
 Boscobel Area Hospital-Boscobel, WI
 Burnett Medical Center-Grantsburg, WI
 Children's Hospital-Minneapolis, MN
 Children's Hospital-St. Paul, MN
 Cumberland Memorial Hospital-Cumberland, WI
 Fairview University Medical Center-Minneapolis, MN
 Fairview University Riverside-Minneapolis, MN
 Gillette Children's Hospital-St. Paul, MN
 Hayward Area Memorial Hospital-Hayward, WI
 Hennepin County Medical Center-Minneapolis, MN
 Hess Memorial Hospital-Mauston, WI
 Holy Family Hospital-New Richmond, WI
 Indianhead Medical Center-Grantsburg, WI
 Lakeview Medical Center-Rice Lake, WI
 Lutheran Hospital-La Crosse, WI
 Memorial Hospital-Neillsville, WI
 Memorial Medical Center-Ashland, WI
 Miller Dwan Medical Center-Duluth, MN
 Myrtle Werth Medical Center-Menomonie, WI
 North Memorial Medical Center-Robinsdale, MN
 OakLeaf Surgical Hospital-Eau Claire, WI
 Our Lady of Victory Hospital-Stanley, WI
 Phillips Eye Institute-Minneapolis, MN
 Prairie du Chien Memorial Hospital-Prairie du Chein, WI
 Regina Medical Center Hospital-Hastings, MN
 Regions Hospital-St. Paul, MN
 River Falls Area Hospital-River Falls, WI
 Rusk County Memorial Hospital-Ladysmith, WI
 Sacred Heart Hospital-Eau Claire, WI
 St. Joseph's Hospital-Chippewa Falls, WI
 St. Joseph's Hospital-Marshfield, WI
 St. Joseph's Memorial Hospital-Hillsboro, WI
 St. Luke's Hospital-Duluth, MN
 St. Mary's Hospital-Superior, WI
 St. Mary's Medical Center-Duluth, MN
 Spooner Health System Hospital-Spooner, WI
 Tri-County Memorial Hospital-Whitehall, WI
 Tomah Memorial Hospital-Tomah, WI
 United Hospital, Inc.-St. Paul, MN
 Vernon Memorial Hospital-Viroqua, WI
 Winona Community Memorial Hospital-Winona, MN

According to its business plan the cooperative's service area is comprised of the following counties:

| | | |
|-------------|------------|-----------|
| Ashland | Barron | Bayfield |
| Buffalo | Burnett | Chippewa |
| Clark | Crawford | Douglas |
| Dunn | Eau Claire | Grant |
| Jackson | Juneau | La Crosse |
| Monroe | Pepin | Pierce |
| Polk | Richland | Rusk |
| St. Croix | Sawyer | Taylor |
| Trempealeau | Vernon | Washburn |

GHC-EC offers comprehensive health care coverage which may be changed to include deductibles and copayments. The following basic health care coverages are provided:

Outpatient Services

- Office visits for diagnosis and treatment of injury and illness
- Diagnostic x-rays, laboratory tests, and procedures
- Preventive health care, including office visits and routine immunizations
- Treatment of allergies including allergens
- Obstetrical care, including prenatal and postnatal maternity care
- Pediatric and well-baby care
- Periodic vision examinations
- Surgical procedures

Referral Services

- Referral specialist care and consultation
- Short-term physical therapy, upon referral of primary care physician
- Mental health service

Inpatient Services

- Unlimited number of days of care
- Room (semi-private)
- Intensive care unit
- X-ray and laboratory service
- Drugs and injections
- Emergency care
- In-hospital physician care
- Ambulance service, authorized by primary care physician and followed by hospital confinement

Additional Services

- Chiropractic care
- Durable medical equipment and prosthetic appliances
- Prescription drugs
- Specified oral surgery procedures

Inpatient mental health services are typically limited to 70 days in the hospital; outpatient mental health is limited to \$500 per person. Inpatient alcohol or drug addiction treatment is limited to 30 days. Durable medical equipment is limited to a \$5,000 lifetime

maximum. Plan coverage is contingent on nonemergency services being provided by participating physicians and hospitals or on the referral of participating physicians.

The cooperative has entered into an agreement with Atrium Health Plan, Inc. (Atrium), a Wisconsin-domiciled health maintenance insurer, under which the cooperative provides Medicaid contract services to recipients enrolled in Atrium's State Medicaid Plan. GHC-EC receives the Medicaid HMO capitation rate based on per member per month less a base fee and less an amount equal to the Health Insurance Risk-Sharing Plan (HIRSP) assessment for all Atrium enrollees. In addition, GHC-EC reimburses Atrium for the net cost of providing credentialing for providers. The initial term of this contract was five and a half years and expired on December 31, 2003. The contract is renewable for five-year terms and currently effective until December 31, 2008. Either party may terminate the contract with 120 days notice. An amendment effective September 1, 1999, included Atrium enrollees in the Wisconsin BadgerCare Program to be included under the terms of the contract.

The cooperative currently markets to groups and individuals. GHC-EC uses marketing staff provided under the management agreement with KMTSJ, Inc. This agreement is outlined in the section of this report captioned, "Management and Control."

GHC-EC uses a modified community rating approach to establishing group premiums. The cooperative's board of directors oversees the general guidelines for premium rate setting. The board delegates the responsibility to its fiscal committee to annually review the budget and establish premium targets, under the guidance of the cooperative's general manager. The general manager establishes specific group rates based on per member per month premium targets. Group rates are adjusted to reflect the age, sex, and coverage characteristics for new and renewal groups. Individual policy premium rates are age and sex rated.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of 16 members; however, 5 positions are vacant at this time. The bylaws state that the number of directors will be at least 15, but not more than 21. All directors shall be members and elected by members in the manner prescribed in the bylaws. The number of health care providers, or their employees, may not exceed 2. Enrollees 18 years of age or older are eligible for board membership, with the exception of individuals employed by or working for GHC-EC. Officers are appointed by the board of directors. No director may be elected to succeed her/himself after having served three consecutive three-year terms. The board members receive \$25 per meeting if they attend at least 75% of all board and committee meetings during the year. The bylaws require the board to meet at least four times each year.

Currently the board of directors consists of the following persons:

| Name and Residence | Principal Occupation | Term Expires |
|-------------------------------------|--|---------------------|
| Cathy Anderson Osseo, WI | Physical Science Teacher Eau Claire School District | 2007 |
| Kelly Childs Eau Claire, WI | Financial Operations Coordinator Nestle USA | 2006 |
| Karen Danielson Eau Claire, WI | Nurse Educator UW of Eau Claire | 2007 |
| Linda Gilbert Altoona, WI | Sales Associate Ameritech/Daytons | 2006 |
| John Halbleib Chippewa Falls, WI | Administrator Fall Creek Valley Care Center | 2008 |
| Jeremy Kiley Eau Claire, WI | Administrator Rutledge Home | 2008 |
| Randy LaPlaca Chippewa Falls, WI | Leadman PBM Bridge | 2008 |
| Robert Sigurdson Eau Claire, WI | Operations Manager Cornell Corp | 2008 |
| Mary Steinke Eau Claire, WI | General Manager Huebsch Services | 2006 |

| Name and Residence | Principal Occupation | Term Expires |
|-----------------------------------|--|---------------------|
| Michele Sweeney Cornell, WI | Sr. Configuration Analyst SGI | 2007 |
| L. Elaine Wendt Eau Claire, WI | Dean College of Nursing/Health Science UW of Eau Claire School of Nursing | 2006 |

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are as follows. These officers comprise the executive committee of the board. Individuals do not receive additional compensation for serving as officers.

| Name | Office |
|-----------------|--------------------------------|
| L. Elaine Wendt | President |
| Cathy Anderson | 1 st Vice President |
| Mary Steinke | 2 nd Vice President |
| Linda Gilbert | Secretary |
| Kelly Childs | Treasurer |

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Bylaws & Nomination Committee

Cathy Anderson, Chair
Karen Danielson
Bob Sigurdson
L. Elaine Wendt

Fiscal Committee

Kelly Childs, Chair
Cathy Anderson
Karen Danielson
Jack Halbleib
Bob Sigurdson
L. Elaine Wendt

Member Relations Committee

Linda Gilbert, Chair
Jack Halbleib
Jeremy Kiley
Randy LaPlaca
Mary Steinke

Personnel Committee

Karen Danielson, Chair
Linda Gilbert
Jeremy Kiley
Mary Steinke
Michele Sweeney

Policy Committee

Mary Steinke, Chair
Cathy Anderson
Kelly Childs
Linda Gilbert
Randy LaPlaca
Michele Sweeney

The cooperative has its own employees in the areas of pharmacy, chiropractic, quality improvement, utilization management and dental services. Necessary administrative staff is provided through a management agreement with KMTSJ, Inc. KMTSJ was organized to enter

into a management agreement with GHC-EC. The corporation is owned and directed by the senior management staff of KMTSJ. The majority of KMTSJ's revenues are derived through the management agreement with GHC-EC. The management company has contributed \$1,250,000 of capital to the cooperative. The provisions of this agreement are outlined below:

- Services: KMTSJ, Inc., agrees to provide accounting, marketing, enrollment, claims processing, personnel management, payroll, information systems, and any other miscellaneous administrative services to GHC-EC. KMTSJ, Inc., also has the responsibility of appointing the general manager and the medical director.
- Purchase Option: The HMO is required to give KMTSJ, Inc., at least 90 days' prior written notice of its intention to dispose or transfer the assets of the HMO. For 60 days after notice is given, KMTSJ, Inc., has the right to acquire the assets and must provide written notice to the HMO within the 60-day time period.
- Compensation: Set percentages of monthly premium and fee-for-service income.
- GHC is also responsible for reimbursement of services for categories specified by the agreement, including information systems activity predominately benefiting the HMO and a percentage of advertising expenses.
- Term: The agreement was initially effective January 1, 1983, with an original term of ten years. A subsequent amendment to the agreement extended the termination date to December 31, 2005, unless renewed. The termination of the contract has been extended for another three-year period. The contract will terminate as of December 31, 2008.
- Termination: Either party may terminate the agreement with at least 120 days' written notice to the other party. If the HMO terminates the agreement, additional payments to KMTSJ, Inc., are required. The amount to be paid is dependent upon the remaining term of the contract at termination.

Financial Requirements

The financial requirements for an HMO under s. Ins 9.04, Wis. Adm. Code, are as follows:

| | Amount Required |
|---|--|
| 1. Minimum capital or permanent surplus | Either: \$750,000, if organized on or after July 1, 1989 or \$200,000, if organized prior to July 1, 1989 |
| 2. Compulsory surplus | The greater of \$750,000 or: If the percentage of covered liabilities to total liabilities is less than 90%, 6% of the premium earned in the previous 12 months; If the percentage of covered liabilities to total liabilities is at least 90%, 3% of the premium earned in the previous 12 months |
| 3. Security surplus | The greater of: 140% of compulsory surplus reduced by 1% of compulsory surplus for each \$33 million of additional premiums earned in excess of \$10 million or 110% of compulsory surplus |
| 4. Operating funds | Funds sufficient to finance any operating deficits in the business and to prevent impairment of the insurer's initial capital or permanent surplus or its compulsory surplus |

Covered liabilities are those due to providers who are subject to statutory hold-harmless provisions.

In addition, there is a special deposit requirement equal to the lesser of the following:

1. An amount necessary to maintain a deposit equaling 1% of premium written in this state in the preceding calendar year;
2. One-third of 1% of premium written in this state in the preceding calendar year.

The company has satisfied this requirement for 2004 with a deposit of \$500,000 with the State Treasurer.

Insolvency Protection for Policyholders

Under s. Ins 9.04 (6), Wis. Adm. Code, requires HMOs to either maintain compulsory surplus at the level required by s. Ins 51.80, Wis. Adm. Code, or provide for the following in the event of the company's insolvency:

1. Enrollees hospitalized on the date of insolvency will be covered until discharged; and
2. Enrollees will be entitled to similar, alternate coverage which does not contain any medical underwriting or preexisting limitation requirements.

The company has met this requirement through its reinsurance contract, as discussed in the "Reinsurance" section of this report.

IV. REINSURANCE AND CORPORATE INSURANCE

The company has reinsurance coverage under the contract outlined below:

- Reinsurer: Standard Security Life Insurance Company of New York (Standard)
- Type: Specific Excess of Loss Reinsurance
- Effective date: January 1, 2005 – January 1, 2006
- Retention: \$100,000 per member per contract year
- Coverage: Eligible inpatient hospital services are limited to an average per day maximum of \$3,500. Eligible inpatient hospital services shall be limited to the lesser of:
- (a) 80% of billed charges; or
 - (b) the contracted amount; or
 - (c) the amount paid by the plan.
- \$1,000,000 maximum per member per contract year
\$2,000,000 maximum lifetime coverage per member.
- Premium: \$1.08 per member per month (PMPM) for commercial and point-of service members.
\$0.85 PMPM for Medicaid Members
- Endorsement C (Insolvency Endorsement): \$0.03 PMPM
Endorsement D (OOA Coverage): \$0.04 PMPM (all commercial members)
- A minimum premium of \$100,000 is required to be paid for the Agreement Year.
- Termination: May be terminated by reinsurer with 31 days' written notice if the plan:
- (a) acquires the assets and liabilities of any other entity;
 - (b) is acquired, comes under control of or is merged with any other entity;
 - (c) comes under partial or total supervision of a regulatory authority having jurisdiction over the plan;
 - (d) loses its HMO or other regulatory license to operate any line of business covered under this agreement;
 - (e) changes the underlying reimbursement contracts in place, member service agreements, the number or type of members covered by the plan or the way in which the plan operates its business so as to materially alter the company's risk.

The reinsurance policy has an endorsement containing the following insolvency provisions:

1. Standard will continue plan benefits for a member who is confined in a hospital or other eligible inpatient facility on the date of insolvency until the earlier of:
 - the member's discharge,
 - the date the member becomes covered under another group or program, or
 - 365 days from the date on which the insolvency occurred.
2. Standard will make available to all members for a period of 30 days from the date of insolvency, without evidence of insurability, a replacement coverage of the same benefit schedule and rates as then being offered by standard to other insureds eligible for conversion within the state.

This coverage is secondary to any other insurance covering members, and any other plan reinsurance coverage. Coverage is limited to \$1,000,000 maximum under the insolvency coverage.

In addition, the cooperative is provided with corporate insurance coverage under the contracts listed below:

| Type of Coverage | Policy Limits |
|---|----------------------|
| Worker's Compensation | |
| Each Accident | \$ 100,000 |
| Policy Limit | 500,000 |
| Each Employee | 100,000 |
| Crime | |
| Fidelity Bond | 800,000 |
| Professional Liability | 1,000,000 |
| Managed Care Errors & Omissions | 1,000,000 |
| Health care medical professional liability (dental) | |
| Each Person limit | 1,000,000 |
| Total Limit | 3,000,000 |
| Property | |
| Building | 789,890 |
| Contents (replacement costs) | 970,000 |
| Computer Equipment (replacement cost) | 50,000 |
| General Liability | |
| General aggregate limit | 2,000,000 |
| Products completed aggregate limit | 2,000,000 |
| Each occurrence | 1,000,000 |
| Medical expense (per person) | 5,000 |
| Umbrella | |
| General aggregate limit | 2,000,000 |
| Products completed aggregate limit | 2,000,000 |
| Each occurrence | 2,000,000 |

The above coverages were obtained through various insurers which are licensed in Wisconsin or provide coverage as a surplus lines insurer.

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2004, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company for the period under examination. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Net Worth per Examination."

Group Health Cooperative of Eau Claire
Assets
As of December 31, 2004

| | Assets | Nonadmitted Assets | Net Admitted Assets |
|--|---------------------|-----------------------|------------------------|
| Bonds | \$ 9,741,969 | \$ 0 | \$ 9,741,969 |
| Real estate: | | | |
| Properties occupied by the company | 518,680 | | 518,680 |
| Cash, cash equivalents and short-term investments | 10,737,595 | | 10,737,595 |
| Other invested assets | 71,174 | | 71,174 |
| Investment income due and accrued | 249,858 | | 249,858 |
| Uncollected premiums and agents' balances in the course of collection | 1,921,036 | | 1,921,036 |
| Amounts recoverable from reinsurers | 110,923 | | 110,923 |
| Current federal and foreign income tax recoverable and interest thereon | 30,000 | | 30,000 |
| Net deferred tax asset | 216,000 | | 216,000 |
| Furniture and equipment, including health care delivery assets | 688,915 | | 688,915 |
| Health care and other amounts receivable | <u>1,164,460</u> | <u> </u> | <u>1,164,460</u> |
| Total assets | <u>\$25,450,610</u> | <u>\$ 0</u> | <u>\$25,450,610</u> |

Group Health Cooperative of Eau Claire
Liabilities and Net Worth
As of December 31, 2004

| | | |
|--|------------------|---------------------|
| Claims unpaid | | \$10,947,000 |
| Accrued medical incentive pool and bonus payments | | 199,785 |
| Aggregate health policy reserves | | 1,738,645 |
| Aggregate health claim reserves | | 22,220 |
| Premiums received in advance | | 3,007,385 |
| General expenses due or accrued | | 680,855 |
| Amounts withheld or retained for the account of others | | <u>38,044</u> |
| Total liabilities | | 16,633,934 |
| Gross paid in and contributed surplus | \$1,001,422 | |
| Aggregate write-ins for other than special surplus funds | 1,430 | |
| Unassigned funds (surplus) | <u>7,813,824</u> | |
| Total capital and surplus | | <u>8,816,676</u> |
| Total liabilities, capital and surplus | | <u>\$25,450,610</u> |

**Group Health Cooperative of Eau Claire
Statement of Revenue and Expenses
For the Year 2004**

| | | |
|---|------------------|---------------------|
| Net premium income | | \$ 55,104,579 |
| Fee-for-service [net of \$(1) medical expenses] | | 684,439 |
| Risk revenue | | <u>49,635,144</u> |
| Total revenues | | 105,424,162 |
| Medical and hospital: | | |
| Hospital/medical benefits | \$71,007,671 | |
| Other professional services | 674,651 | |
| Emergency room and out-of-area | 3,867,271 | |
| Prescription drugs | 17,002,480 | |
| Aggregate write-ins for other medical and hospital | 59,303 | |
| Incentive pool and withhold adjustments | <u>75,758</u> | |
| Subtotal | 92,687,134 | |
| Less | | |
| Net reinsurance recoveries | <u>343,286</u> | |
| Total medical and hospital | 92,343,848 | |
| Non-health claims | | |
| Claims adjustment expenses | 1,374,612 | |
| General administrative expenses | 10,793,336 | |
| Increase in reserves for life and accident and health contracts | <u>1,602,645</u> | |
| Total underwriting deductions | | <u>106,114,441</u> |
| Net underwriting gain or (loss) | | (690,279) |
| Net investment income earned | | <u>546,746</u> |
| Net income (loss) | | <u>\$ (143,533)</u> |

**Group Health Cooperative of Eau Claire
Capital and Surplus Account
As of December 31, 2004**

| | |
|---|--------------------|
| Capital and surplus prior reporting year | \$8,960,209 |
| Net income or (loss) | <u>(143,533)</u> |
| Capital and surplus end of reporting year | <u>\$8,816,676</u> |

**Group Health Cooperative of Eau Claire
Statement of Cash Flows
As of December 31, 2004**

| | | |
|---|------------------|---------------------|
| Premiums collected net of reinsurance | | \$ 50,764,570 |
| Net investment income | | 524,695 |
| Miscellaneous income | | <u>50,319,583</u> |
| Total | | 101,608,848 |
| Less: | | |
| Benefit and loss related payments | \$95,888,978 | |
| Commissions, expenses paid and aggregate write-ins for deductions | 12,167,948 | |
| Federal and foreign income taxes paid (recovered) | | |
| \$0 net tax on capital gains (losses) | <u>283,000</u> | |
| Total | | <u>108,339,926</u> |
| Net cash from operations | | (6,731,078) |
| Proceeds from investments sold, matured or repaid: | | |
| Bonds | \$11,090,070 | |
| Miscellaneous proceeds | <u>23,398</u> | |
| Total investment proceeds | | 11,113,468 |
| Cost of investments acquired - long-term only: | | |
| Bonds | <u>6,928,411</u> | |
| Net cash from investments | | 4,185,057 |
| Cash provided/applied: | | |
| Other cash provided (applied) | | <u>(60,321)</u> |
| Net change in cash and short-term investments | | (2,606,342) |
| Beginning of year (cash and short-term investments) | | <u>13,343,937</u> |
| End of year (cash and short-term investments) | | <u>\$10,737,595</u> |

Growth of Group Health Cooperative of Eau Claire

| Year | Assets | Liabilities | Capital and Surplus | Premium Earned | Risk Revenue | Medical Expenses Incurred | Net Income (Loss) |
|------|--------------|--------------|---------------------|----------------|--------------|---------------------------|-------------------|
| 2004 | \$24,450,610 | \$16,633,934 | \$8,816,676 | \$55,104,579 | \$49,635,144 | \$92,343,848 | \$ (143,533) |
| 2003 | 32,332,473 | 23,372,264 | 8,960,209 | 61,599,139 | 45,571,546 | 92,957,222 | 3,667,162 |
| 2002 | 26,591,938 | 21,298,891 | 5,293,047 | 57,868,412 | 39,841,807 | 87,974,911 | 459,366 |
| 2001 | 24,157,543 | 19,323,862 | 4,833,681 | 49,064,288 | 37,873,630 | 80,578,845 | (352,505) |

| Year | Profit Margin | Medical Expense Ratio | Administrative Expense Ratio | Change in Enrollment |
|------|---------------|-----------------------|------------------------------|----------------------|
| 2004 | -0.1% | 89.1% | 11.5% | -10.3% |
| 2003 | 3.4 | 86.2 | 10.9 | -2.0 |
| 2002 | 0.5 | 89.6 | 10.5 | -1.4 |
| 2001 | -0.4 | 92.7 | 8.8 | 20.9 |

Enrollment and Utilization

| Year | Enrollment | Hospital Days/1,000 | Average Length of Stay |
|------|------------|---------------------|------------------------|
| 2004 | 21,932 | 375.88 | 3.3 |
| 2003 | 24,448 | 371.32 | 3.2 |
| 2002 | 24,934 | 341.96 | 3.4 |
| 2001 | 25,292 | 387.14 | 3.5 |

Per Member Per Month Information

| | 2004 | 2003 | Percentage Change |
|--|-----------------|-----------------|-------------------|
| Premiums: | | | |
| Commercial | \$287.65 | \$291.16 | -1.2% |
| Medicaid | 151.64 | 141.15 | 7.4 |
| Expenses: | | | |
| Hospital/medical benefits | 269.87 | 240.68 | 12.1 |
| Other professional services | 2.51 | 2.24 | 11.8 |
| Outside referrals | | | |
| Emergency room and out-of-area | 14.38 | 12.49 | 15.1 |
| Other medical and hospital | 0.22 | 0.23 | -4.6 |
| Incentive pool and withhold adjustments | 0.28 | 0.30 | -6.1 |
| Less: Net reinsurance recoveries | <u>1.28</u> | <u>1.15</u> | 11.3 |
| Total medical and hospital | 285.98 | 255.94 | 11.7 |
| Claims adjustment expenses | 5.11 | 2.11 | 142.2 |
| General administrative expenses | 40.13 | 37.87 | 6.0 |
| Increase in reserves for accident and health contracts | <u>5.96</u> | <u>0.00</u> | 100.0 |
| Total underwriting deductions | <u>\$337.18</u> | <u>\$295.92</u> | 13.9 |

GHC-EC experienced decreased enrollment during the examination period, with a 10.3% decrease in 2004. The primary cause of the decreased enrollment is due to some of the cooperative's commercial business offering more than one insurance plan to employees and the State of Wisconsin implementing a multi-tier system for state employees and retirees. Management asserts that groups offering other types of coverage to their employees resulted in the healthy employees going to the lower cost plans while those that were unhealthy staying with GHC-EC for the HMO type coverage.

As a result of this adverse selection, it was determined that a premium deficiency reserve of \$4.3 million at December 31, 2004, was necessary. A premium deficiency reserve is created when a contract or a group of related contracts have projected medical and administrative expenses in excess of projected premium. GHC-EC requested, and received, a permitted practice from this office to record \$1.5 million of the deficiency. The deficiency may reverse in 2005 as the cooperative has taken action by increasing rates to match the utilization of the unprofitable groups. In addition, several groups whose experience contributed to the deficiency reserve have opted not to renew their coverage in 2005. This event was not considered during the original calculation of the premium deficiency reserve.

Reconciliation of Capital and Surplus per Examination

The examination made no adjustments to the cooperative's reported capital and surplus at December 31, 2004.

The following is a reconciliation of reclassifications as determined by the examination:

| | Debit | Credit |
|---|-----------------------------|--------------------|
| Premiums received in advance | \$1,792,708 | \$ |
| Uncollected premiums and agents' balances in the course of collection | <u> </u> | <u>1,792,708</u> |
| Total reclassifications | <u>\$1,792,708</u> | <u>\$1,792,708</u> |

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were 17 specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Financial Reporting—It is recommended that the cooperative properly complete future statutory statements, in accordance with NAIC and OCI instructions, giving particular attention to the items noted above.

Action—Compliance.
2. Financial Reporting—It is recommended that the cooperative properly classify balances on the Statement of Revenue and Expenses as instructed in the NAIC Annual Statement Instructions for Health Insurers.

Action—Compliance.
3. Financial Reporting—It is recommended that the cooperative depreciate health care delivery assets as required by SSAP NO. 73.

Action—Compliance.
4. Business Plan—It is recommended the cooperative file its business plan with this office within 60 days of adoption of this report as requested during the examination pursuant to s. 601.42, Wis. Stat.

Action—Compliance.
5. Conflict of Interest—It is recommended that Conflict of Interest Statements be completed by the General Manager and Director of Finance.

Action—Compliance.
6. Related Party—It is recommended that the cooperative draft a formalized agreement with its PBM, PharmaStar.

Action—Compliance.
7. Insolvency Coverage—It is recommended that the cooperative maintain net worth at the level required by s. Ins 51.80, Wis. Adm. Code, or make provisions for insolvency coverage as required by s. Ins 9.04 (6), Wis. Adm. Code.

Action—Compliance.
8. Custodial Agreement—It is recommended that the cooperative obtain a custodial agreement with proper language as required by the NAIC *Financial Condition Examiners' Handbook* and s. Ins 610.23 (1), Wis. Stat., and submit the agreement within 90 days of the adoption of the report.

Action—Compliance. This recommendation was no longer applicable to the cooperative.

9. Corporate Insurance Coverages—It is recommended that the cooperative require its management company to obtain blanket employee dishonesty insurance (i.e., fidelity bond) in at least the minimum amounts suggested by the NAIC *Financial Condition Examiners' Handbook* and develop a procedure to ensure the cooperative has the minimum level of suggested coverage.

Action—Compliance.

10. Invested Assets—It is recommended that the cooperative develop a plan that outlines how the cooperative will comply with compulsory surplus requirements for future filings and file the plan with this office within sixty days of adoption of this report.

Action—Compliance.

11. Allowances—It is recommended the cooperative discontinues the practice of offsetting its receivable with an allowance and evaluate its receivables for collectibility pursuant to SSAP No. 3.

Action—Compliance.

12. General Expenses Due and Accrued—It is recommended that the cooperative correctly classify its provider bonuses on the annual statement pursuant to the NAIC Annual Statement Instructions for Health Insurers.

Action—Compliance.

13. General Expenses Due and Accrued—It is recommended that the cooperative correctly report its withholds pursuant to the NAIC Annual Statement Instructions for Health Insurers.

Action—Compliance.

14. Rates—It is recommended the cooperative provide this office with detail on its premium rate model as requested during the examination pursuant to s. 601.42, Wis. Stat.

Action—Compliance.

15. Information Systems—It is recommended that the cooperative enhance its current disaster recovery paying specific attention to the items addressed above.

Action—Partial-compliance, see comments in the summary of current examination results.

16. Information Systems—It is recommended that minimum coding and documentation standards be developed and formally implemented for IT projects.

Action—Compliance.

17. Information Systems—It is recommended that access to the computer room by pharmacy personnel be removed.

Action—Compliance.

Summary of Current Examination Results

Conflict of Interest

Review of the Conflict of Interest Statements for the examination period and 2005 noted that members of the cooperative's senior management staff did not report all conflicts on their Conflict of Interest Statements. On the 2005 statements, all senior management owning shares of KMTSJ, Inc., except one individual, stated they had no conflicts; but in prior years these same individuals noted that they owned shares of KMTSJ, Inc. (the cooperative's management company). As of the examination date these individuals still owned shares in the management company; therefore, this situation should have been disclosed. The form's construction created an ambiguity as to whether information reported on previous statement's needed to be reported again. It is recommended that Conflict of Interest Statements be modified to more clearly state disclosure requirements and be properly completed by members of the senior management staff.

Provider Contracts

The review of the cooperative's provider contracts disclosed that one contract with capitated rates did not have an amendment that stated the current capitation rates. Through inquiry with the cooperative's staff it was determined that the contract rates are updated on an annual basis via a verbal agreement between the provider and the cooperative's general manager. Verbal agreements with providers are not considered to be good business practices. It is recommended that all amendments to provider contracts be documented and signed by both parties involved.

Premium

The examination's review of the cooperative's "Uncollected premiums and agents' balances in the course of collection" and "Premiums received in advance" noted that the December 2004 balance for these two accounts was overstated by \$1,792,708. This resulted in an examination reclassification of \$1,792,708. This reclassification is reflected in the section of this report captioned "Reconciliation of Capital and Surplus per Examination." The cooperative billed its January 2005 premium in December 2004 and recorded an accounts receivable for the premium when it was billed and recorded a liability for advanced premium at the same time.

Pursuant to the NAIC Statements of Statutory Accounting Principles (SSAPs) No. 6, premiums receivables shall be recognized based on effective date of the insurance contract. Also, pursuant to SSAP No. 54, advanced premiums are those premiums that have been received by the entity prior to the valuation date. It is recommended that the cooperative correctly report "Uncollected premiums and agents' balances in the course of collection" and "Premiums received in advance" in accordance with SSAPs No. 6 and 54. It should be noted that the cooperative has properly recorded "Uncollected premiums and agents balances in the course of collection" and "Premiums received in advance" in subsequent filings with the Office of the Commissioner of Insurance.

Information Systems

The prior examination recommended that the cooperative enhance their disaster recovery plan paying attention to the following items:

- The disaster recovery plan should address its hardware restoration procedures or list the necessary hardware.
- The plan should list manual procedures that would be performed in the event the system was unavailable.
- The plan should include a call tree to identify how the cooperative would communicate to its employees.

During the current examination it was noted that the cooperative had improved its disaster recovery plan but did not adequately address these issues in enhancing its disaster recovery plan. It is again recommended that the cooperative enhance its disaster recovery plan to address the restoration of its hardware and manual procedures for critical business functions, including necessary supplies, in the event the automated systems are not available.

The examination noted that the cooperative's disaster recovery plan identified was not current. The plan provided was dated October 21, 2002, with updates of phone number in 2004. The cooperative tested the plan in 2004. The issues noted in the testing have not been integrated into the plan as of examination fieldwork. In addition, testing did not include validation that critical vendors and supplies would be available in the event of a disaster, and there was no consideration of restoration of the IT infrastructure. For a disaster recovery plan to be relevant, it needs to be reviewed, updated, and tested on a periodic basis, no greater than annually. The testing should address all significant business activities, including IT infrastructure, validation with respect to availability of critical vendors, and supplies to carry out the disaster plan. It is

recommended that the cooperative review, update, and test its disaster recovery plan at least annually.

It was noted during the examination that the cooperative does not have a formal policy for the review of security violations or intrusion detection. Security violations are not monitored in the event logs and the review for intrusion detection is the responsibility of the Web developer whose position is currently vacant. It is recommended that the cooperative implement a formal process for the review of security violations and intrusion detection.

It was noted during the examination that the cooperative has an informal process for validating that active IDs are authorized and that the access for an ID is commensurate with the individual's responsibilities. The cooperative should make this process formal to evidence the occurrence that IDs are authorized and access to the ID is relevant with the individual's responsibilities. It is recommended the cooperative create and implement a formal process to validate that all active IDs are authorized and that the access for an ID is commensurate with the individual's responsibilities.

Compulsory Surplus Requirement

As noted in the section of this report captioned "Financial Requirements," HMOs are required to maintain minimum compulsory surplus. The company's calculation as of December 31, 2004, was as follows:

| | | |
|-------------------------------|---------------|--------------------|
| Assets | \$25,450,610 | |
| Less: | | |
| Special deposit | 524,983 | |
| Liabilities | 16,633,934 | |
| Investment in coop bank stock | <u>71,174</u> | |
| Total | | \$8,220,519 |
| Net premium earned | 55,104,579 | |
| Compulsory factor | <u>3%</u> | |
| Compulsory surplus | | <u>1,653,137</u> |
| Compulsory Excess | | <u>\$6,567,382</u> |

VII. CONCLUSION

Group Health Cooperative of Eau Claire's annual statement as of December 31, 2004, reported assets of \$24,450,610, liabilities of \$16,633,934, and surplus of \$8,816,676. Operations for 2004 resulted in a net loss of \$143,533.

The cooperative has its own employees in the areas of pharmacy, chiropractic, quality improvement, utilization management, and dental services. Administrative staff is provided through a management agreement with KMTSJ, Inc.

The cooperative received a permitted practice to record \$1.5 million of a \$4.3 million premium deficiency for 2004. The deficiency is the result of poor underwriting results from the cooperative's commercial block of business and may reverse during 2005.

The cooperative complied with 16 of 17 of the prior recommendations and partially complied with one recommendation. The current examination resulted in one reclassification of \$1,792,708 from "Premiums received in advance" to "Uncollected premiums and agents' balances in the course of collection" and seven recommendations as summarized on the following page.

VII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 24 - Conflict of Interest—It is recommended that Conflict of Interest Statements be modified to more clearly state disclosure requirements and be properly completed by members of the senior management staff.
2. Page 24 - Provider Contracts—It is recommended that all amendments to provider contracts be documented and signed by both parties involved.
3. Page 25 - Premium—It is recommended that the cooperative correctly report “Uncollected premiums and agents’ balances in the course of collection” and “Premiums received in advance” in accordance with SSAPs No. 6 and 54.
4. Page 25 - Information Systems—It is again recommended that the cooperative enhance its disaster recovery plan to address the restoration of its hardware and manual procedures for critical business functions, including necessary supplies, in the event the automated systems are not available.
5. Page 25 - Information Systems—It is recommended that the cooperative review, update, and test its disaster recovery plan at least annually.
6. Page 26 - Information Systems—It is recommended that the cooperative implement a formal process for the review of security violations and intrusion detection.
7. Page 26 - Information Systems—It is recommended the cooperative create and implement a formal process to validate that all active IDs are authorized and that the access for an ID is commensurate with the individual's responsibilities.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

| Name | Title |
|------------------|---|
| DuWayne Kottwitz | Insurance Financial Examiner |
| Randy Milquet | Insurance Financial Examiner - Advanced |

Respectfully submitted,

Amy J. Wolff
Examiner-in-Charge